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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re INTERACTIVE NETWORK, INC., a California corporation, Debtor.	Bankruptcy Case No. 98-34055DM Chapter 11

MEMORANDUM DECISION

I. Introduction

The court conducted a trial on July 13 and 14, 2000, on the objections of Interactive Network, Inc. ("Debtor") to the Amended Proof Of Claim ("Claim") of National Datacast, Inc. ("NDI"). Debtor appeared and was represented by David Bayless, Esq. and Kristin Moody, Esq.; NDI appeared and was represented by Lawrence A. Katz, Esq. and Harvey S. Schochet, Esq.

Having considered the testimony of the witnesses, the documentary evidence, and the arguments of counsel, the court concludes that the contractual relationship of the parties is governed by California law; that on NDI's Claim based upon lost right of first refusal fees it is entitled to a small portion of those fees, together with interest at the rate of 10% per annum

from September 14, 1994 to the date of Debtor's Chapter 11 petition, September 14, 1998; and that NDI is entitled to its lost profits on account of Debtor's breach of contract, but it is not entitled to pre-petition interest on that portion of the Claim.

II. Discussion[1]

Through a series of letters and amendments between September 30, 1988 and January 18, 1994, Debtor and NDI were parties to an agreement ("Agreement"),[2] the principal terms of which at issue before the court were: (1) NDI's providing of data services to Debtor and Debtor's agreement to pay agreed amounts per month (the "Service Fees") throughout the term of the Agreement; and (2) what the parties have called an option ("Option"),[3] whereby Debtor agreed that, beginning at a time when Debtor achieved what the parties described as Debtor's Initial Market Launch ("Launch"), the Debtor would pay for the right to acquire use of NDI's last available data distribution channel capable of transmitting 9.6 kbs, known as a vertical blanking interval ("VBI"). The parties agreed that the Launch meant the date on which Debtor first

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[1] The following discussion constitutes the court's findings of fact and conclusions of law. Fed. R. Bankr. P. 7052(a).

[2] At the outset of their contractual relationship the early versions of the Agreement were entered into between NDI's predecessor and Debtor under its former name. For convenience the court will treat the Agreement in all respects and at all times as being between Debtor and NDI.

[3] Although the Option was actually a right of first refusal, at trial the parties used the terms almost interchangeably, and so does some of the evidence. While there is a difference between the two terms, the difference is immaterial for purposes of this dispute and for simplicity this court will adopt the parties' terminology.

offered terminal services for sale at arm's length in one or more major markets.

The Agreement is significant for what it does not provide. Specifically, there is no choice of law provision, nor is there any provision setting forth the rights of either party upon breach by the other.

A. The Option Fees

The Option was to begin when the Launch occurred, as the parties agreed at the outset on September 30, 1988. By an amendment to the Agreement dated November 14, 1990, the parties modified Debtor's obligations to pay certain fees to NDI as set forth in paragraph 5 of the September 30, 1988 letter, the same paragraph where the Launch is defined. Debtor contends that language in the November 14, 1990 amendment -- to the effect that "In lieu of Paragraph 5 of the Letter Agreement ... fees and payment schedule shall be..." as set forth thereafter -- did away with the definition of the Launch. This was not an elimination of the definition of the Launch since the November 14, 1990 letter only dealt with an adjustment to Debtor's obligations to pay the November 1990 version of the Service Fees.

In April, 1991, Debtor offered its services in the market area of Sacramento, California to third party customers. This constituted the Launch and triggered Debtor's obligations to pay monthly fees for the Option. At that time and continuing until early 1995, Debtor accrued $5,000 a month in Option fees on its books, although at no time did NDI bill or invoice Debtor for those fees, nor make any demand concerning them. Nor did Debtor

ever pay any Option fees. In fact, the evidence is unequivocal that NDI completely overlooked its right to be paid Option fees even though it was aware of the occurrence of the Launch almost immediately after it had taken place.

In February 1995, Jay Trager, NDI's Chief Operating Officer and General Manager, and Jacquelyn Weiss, NDI's Chief Executive Officer, had a conversation with Terry Donaher, Debtor's Senior Vice-President for Broadcast Operations. The Option fees were discussed only in passing when the parties were together; subsequently, on February 27, 1995, Mr. Donaher advised Mr. Trager that Debtor had been accruing a monthly $5,000 charge but had not been paying NDI. At the same time Mr. Donaher advised Mr. Trager that Debtor no longer needed the Option for the extra VBI line, and therefore was terminating the Option and informing its accounting department to cancel the monthly accrual.

NDI made no response to Mr. Donaher's letter, and in fact never did anything either internally or vis-a-vis Debtor concerning the Option fees until it filed the original proof of claim in this Chapter 11 case on December 29, 1998. In that proof of claim it included a demand for $580,000 in unpaid Option fees, with interest in the amount of $292,594.44 through the date of Debtor's Chapter 11 petition.[4]

[4] The Claim also includes a demand for post-petition interest. Such interest must be paid on any allowed unsecured claim pursuant to the terms of Debtor's confirmed Chapter 11 plan of reorganization.

B. The Service Fees

Although NDI has been paid the Service Fees portion of its Claim -- for $416,665 in unpaid Service Fees and $133,448.54 in interest -- the history of the Service Fees is important for two reasons. First, Debtor claims that in the course of negotiations over Service Fees NDI modified or abandoned its claim for the Option fees. Second, the history of Debtor's non-payment is relevant to Debtor's argument that NDI, not Debtor, was responsible for any profits it lost.

Debtor paid the Service Fees until early 1995, although there were many occasions when Debtor fell behind in its payments and had to catch up or otherwise make arrangements with NDI. It is true, as Debtor argues, that various documents exchanged between the parties when the catch-ups or cures of delinquencies were made state that (as of the appropriate date) Debtor was current in its obligations to NDI. However, it is clear from the documents and the testimony that the parties were only negotiating cures of delinquencies or defaults in the payment of Service Fees or other obligations, and were never dealing with the unpaid and unbilled Option fees.

Debtor's catch-ups or cures ceased in 1995. By September 15, 1995, Debtor had failed to pay its Service Fees for the months of May, June, July, August and September, 1995. By the same date Debtor had stopped delivering data to NDI for transmission to its own customers and in fact had terminated virtually all of its business activities. It was not even responding to calls or communications from NDI or other creditors and only had one full-time employee. NDI then terminated the Agreement as of September

18, 1995 by letter. The letter kept open the possibility that if Debtor "is able to get back on its feet", NDI would like the opportunity to provide further service to Debtor, "subject to [Debtor's] ability to pay NDI all past due amounts...."

C. NDI's Claim for Lost Profits

NDI's Claim also seeks lost profits of $3,916,667 (the "Lost Profits"), representing 100% of the $83,333 monthly Service Fees owed by Debtor under the Agreement from the time the Agreement was terminated (through February 29, 2000), together with interest in the sum of $946,528.[5]

In asserting the portion of the Claim for the delinquent Service Fees owed for five months in 1995, NDI demanded interest in accordance with section 3289 of the California Civil Code. In the portion of its Claim for the Lost Profits, NDI cited section 3300 of the California Civil Code.

The Claim also acknowledged that Debtor was entitled to a credit of $25,000; subsequently NDI determined that that credit was no longer appropriate and had been set forth in the Claim in error. Debtor did not challenge that elimination of the credit and it will be treated as having been withdrawn from the Claim.

III. Analysis

A. California law applies.

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[5] As with the Option fees, the court is focusing only on the Claim through the date of the petition; to the extent the Claim is allowed in any amount as of that date, Debtor's Chapter 11 plan of reorganization requires Debtor to pay interest on account of allowed claims.

NDI would have the court apply Virginia law, rather than California law, to determine the rights of the parties. This contention comes late, and is without merit in any event.

As noted above, in the Claim NDI relies on California law to assert a 10% interest accrual on the unpaid Service Fees and to recover the Lost Profits. Even at the origin of the Agreement, the parties specifically incorporated the provisions of California Code of Civil Procedure section 1283.05 (providing for depositions to be taken and discovery obtained in arbitration proceedings) into the Agreement as an agreement to arbitrate. They also contemplated replacing the Agreement with a Network Management Agreement on terms to be negotiated. If the parties were unable to reach agreement on specific terms of the contemplated Network Management Agreement, they both agreed to submit any such dispute to binding arbitration pursuant to the California Arbitration Law (Code of Civil Procedure sections 1280-1294.2). While the arbitration provisions cited above are not specifically "choice of law" terms, they are a clue which the court finds persuasive in determining that there was no contemplation that Virginia law would apply; California is the only proper alternative. Further, the two references to California law in the Claim constitute a waiver of any contention that Virginia law applies.

Even if the court disregards the references to California law found in the Claim and the Agreement, as discussed above, California law still applies for any one of several reasons. As discussed below, in this circuit a bankruptcy court applies either (a) federal choice of law rules, which generally follow the Restatement (Second) Conflict of Laws ("Restatement"), or (b) the

choice of law rules of the forum (California). Under either set of rules, California law governs the issues in dispute.

The Ninth Circuit has suggested that in bankruptcy cases federal choice of law rules should apply, at least where there are federal questions presented to the court. Lindsay v. Beneficial Reinsurance Co. (In re Lindsay), 59 F.3d 942, 948 (9th Cir. 1995). While the dispute between Debtor and NDI is not a federal question, and the matter is presented to the court on non-bankruptcy issues in a claims objection, Lindsay has been followed in state law disputes presented to the bankruptcy court. In re Gibson, 234 B.R. 776, 779 (Bankr. N.D. Cal. 1999).

Assuming that federal choice of law rules apply to this non-bankruptcy dispute, the Ninth Circuit has not fully defined those rules. However, the Lindsay decision followed the Restatement, and this court will do likewise.

Under the Restatement, "[i]n general, unless the exceptional circumstances of the case make such a result unreasonable: [¶] (1) [t]he forum will apply its own statute of limitations barring the claim." Restatement § 142(1) (Rev. 1988). As to issues other than statutes of limitation, such as the legal rate of interest, the Restatement's choice of law factors include: the needs of the interstate and international systems, the relevant policies of the forum, the relevant policies of other interested states, the protection of justified expectations, the basic policies underlying the particular field of law, certainty, predictability and uniformity of result, and ease in the determination and application of the law to be applied. Restatement § 6 (1971). The majority of these factors also favor California law, for the

reasons stated below in connection with California choice of law rules.

Moreover, there is some authority that on non-bankruptcy issues a bankruptcy court will always apply the choice of law rules of the forum. Hall v. Perry (In re Cochise College Park, Inc.), 703 F.2d 1339, 1348 n. 4 (9th Cir.1983) (bankruptcy court should determine materiality of contract breach pursuant to "the choice of law rules of the state in which the court sits") (decided under Bankruptcy Act of 1898); Rubenstein v. Ball Bros, Inc. (In re New England Fish Co.), 749 F.2d 1277, 1280-1281 (9th Cir. 1984) ("In deciding questions of state law, a bankruptcy court should apply the law that a court of the forum state would apply.").

Therefore, if the Restatement does not apply, this court must look to California's choice of law rules. The only California choice of law statute cited by the parties is California Civil Code section 1646.[6] NDI argues that under section 1646 the place of performance determines the applicable law, and that Virginia is the place of performance. NDI also cites a federal diversity case

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[6] California Civil Code section 1646 provides:

> Law of Place. A contract is to be interpreted according to the law and usage of the place where it is to be performed; or if it does not indicate a place of performance, according to the law and usage of the place where it is made.

As the Ninth Circuit has noted, "There appears to be some difference of opinion as to whether California's choice of law rule for contracts is the governmental interest test of Reich v. Purcell, 67 Cal.2d 551, 553, 63 Cal.Rptr. 31, 432 P.2d 727 (1967), or the test of Cal.Civ.Code § 1646 ...." Arno v. Club Med Inc., 22 F.3d 1464, 1468 n.6 (9th Cir. 1994). This court need not address the issue, however, because the same result obtains under either analysis.

applying Virginia law for the same principle, although as stated above, Virginia choice of law rules do not apply. See Sneed v. American Bank Stationary Co., 764 F.Supp. 65 (W.D. Va. 1991).

Section 1646 looks first to whether the parties' agreement specifies the place of performance. The agreement in this case is silent on the issue. Moreover, if there can be said to be any place of performance, this court would find that it is California. By and large Debtor's performance (payment, and timely transmission of data to NDI) was required in California. NDI's performance (re-transmission of the data) was to occur in Virginia and the states to which it re-transmitted the data. However, NDI's performance did not consist of much beyond reliance on its pre-existing infrastructure: NDI argues in connection with its Lost Profits analysis that it has de minimus expenses associated with re-transmitting Debtor's data. While this is a closer call, if the place of performance governs, this court would apply California law.

Section 1646 has an alternative to the place of performance test. If the contract does not indicate the place of performance, then section 1646 states that it should be interpreted according to the law and usage of the place where it is made. In this case, that place is far from clear.

While the initial letter of September 30, 1988 appears to have been executed by NDI in Virginia after Debtor signed in California, that same sequence was not followed in the various agreements that followed. Sometimes Debtor signed before NDI, sometimes after. Thus, section 1646 either provides that California law governs, or it is inapplicable.

In the absence of a controlling statute, this court looks to California case law. For statutes of limitation, there is some authority that California will always apply its own law to protect a California defendant, even if the parties specify a different law. See Ashland Chemical Co. v. Provence, 129 Cal. App. 3d 790, 181 Cal. Rptr. 340 (1982)(court applied California statute of limitations *notwithstanding* parties' contractual choice of Kentucky law), questioned by Hambrecht & Quist Venture Partners v. American Medical Internat., Inc., 38 Cal. App. 4th 1532, 1549 n.17; 46 Cal. Rptr. 2d 33, 43 n.17 (1995), review denied (1996) (following contract's choice of law to apply shorter statute of limitations, consistent with Ashland, but questioning Ashland for disregarding the parties' own choice of law).

More generally, California applies the "governmental interest test" first articulated in Reich v. Purcell, 67 Cal.2d 551, 63 Cal. Rptr. 31, 432 P.2d 727 (1967). See Ashland, supra, 129 Cal. App. 3d 790, 793-794; 181 Cal. Rptr. 340, 341; Hambrecht, supra, 38 Cal. App. 4th 1532, 1543-44 & n.9; 46 Cal. Rptr. 2d 33, 39-40 & n.9.[7]

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[7] Counsel for NDI has taken inappropriate liberties in arguing that Virginia law applies under the governmental interest test. In the supplemental trial brief at fn. 3, there is a discussion of Rosco, Inc. v. TIG Insurance Co., 1998 WL 66705, a Ninth Circuit unpublished decision at 139 F.3d 907 (Table). Citation of this case violates Rule 36-3 of the United States Court of Appeals for the Ninth Circuit. That rule indicates that a disposition that is not an opinion or an order designated for publication shall not be regarded as precedent and shall not be cited to or by [the Ninth Circuit] or any district court of the Ninth Circuit (except under inapplicable exceptions). This court is a unit of the district court (28 U.S.C. § 151) and the citation is improper. More importantly, NDI's counsel's discussion of Roscoe is wrong. The court did not indicate that the lower court's decision to disregard California Civil Code section 1646

The governmental interest test requires the court to consider the substantive laws of the interested states, the conflict between those interested states' laws, and the potential impairment of a state's interest if one state's policies are subordinated to another's. Rosenthal v. Fonda, 862 F.2d 1398, 1400 (9th Cir. 1988). Here the substantive laws of California and Virginia are the only choices, those states being the domiciles of the two adversaries and the principal places of performance by those adversaries. California is the state where the underlying action (here the Claim and Debtor's objection) is being pursued, and where this court sits.

The conflict primarily arises in choosing which statute of limitations to apply to NDI's attempt to recover Option fees.[8] Under Virginia law,[9] NDI would have one more year prior to Debtor's bankruptcy in which it could reach back for the Option fees than under California law.[10] The court is not aware of any significant difference in the Lost Profit analysis, except for some California case law cited by Debtor but distinguished by this

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was reversible error. In fact the Ninth Circuit reversed the district court's determination that California law applied to the dispute, finding that New York law applied under both Civil Code section 1646 and the governmental interest test. The district court's error, therefore, was on the merits and not on the test it applied.

[8] 11 U.S.C. § 502(b)(1) permits Debtor to assert most defenses (including statute of limitations) that would be available to it under applicable law.

[9] Section 8.01-246(2) of the Code of Virginia provides a five year statute of limitations.

[10] California Code of Civil Procedure § 337.1 provides a four year statute of limitations.

court.[11] Although it is anomalous, the selection of California law actually favors NDI in the application of interest on the amount of the Claim to be allowed based upon unpaid Option fees.[12]

The last part of the governmental interest test is to consider the potential impairment of each state's interests. Plainly California's interests prevail here because its law protects its domiciliary (i.e., Debtor), from the need to defend stale actions.

In Ashland Chemical, supra, the court balanced the governmental interests and chose California law. One of the important factors in the court's decision (similar to what is presented here) was that the foreign state (Kentucky) had a longer statute of limitations than California, yet the plaintiff had chosen to file suit in California when it could have done so elsewhere. So too here, NDI could have pursued Debtor in Virginia prior to bankruptcy but, since it did not, Debtor's interests are enhanced by application of California law, and thus the shorter statute of limitations. There is no particular governmental interest of Virginia that is at stake in this dispute.

For all of the foregoing reasons, whichever choice of law analysis this court follows leads to the same result. California law applies to determine the statute of limitations and other issues in dispute.

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[11] See discussion of Postal Instant Press, Inc. v, Sealy, 43 Cal. App. 4th 1704, 51 Cal. Rptr. 2d 365, at part III.D. of this Memorandum Decision, infra.

[12] See discussion at part III.E. of this Memorandum Decision, infra.

B. Debtor is obligated to pay the Option fees but NDI may only collect the fees that became due and owing within four years of Debtor's Chapter 11 case.

Although the Agreement was amended many times, the definition of Launch found in paragraph 5 of the September 30, 1988 letter, which is the first version of the Agreement, survives subsequent amendments. On November 14, 1990 the parties agreed upon a change in the terms and schedule of payments of Service Fees. The schedule and the amounts were set forth in a letter of that date "in lieu of" the schedule that appeared in paragraph 5 of the earlier letter. There was no change in the latter letter of either the definition of Launch or NDI's right to Option fees. Similarly, on October 7, 1991 the parties entered into another letter agreement that once again dealt with Service Fees. The "in lieu of" reference to paragraph 5 of the September 30, 1988 letter appeared again, but as previously, there was no change in either the definition of Launch (which had already occurred) or NDI's right to Option fees.[13]

There can be no doubt that Debtor was aware of the occurrence of the Launch and the commencement of its obligations to NDI on account of Option fees because as of May, 1991, Debtor's own accounts payable department began accruing the $5,000 per month Option fee that applied for the first calendar year after the Launch.

Those accruals continued until February 27, 1995, when Debtor

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[13] Plainly the parties knew how to delete an applicable paragraph of the Agreement. By letter amendment of January 18, 1994, "paragraphs 2 and 5 of the [Agreement] are hereby deleted in their entirety...." There was no need to define the Launch any longer since it had occurred and Debtor had been accruing Option fees for approximately three years.

advised NDI in writing "to terminate our option for a second line." The parties agree that after February, 1995, NDI was not entitled to any future Option fees. Where they differ, however, is whether the February 27 letter constituted a tolling of the applicable statute of limitations.[14] The acknowledgment of a debt, sufficient to toll the statute of limitations, must be direct, distinct, unqualified, and an unconditional admission of a debt which the party is liable and willing to pay. Clunin v. First Federal Trust Co., supra, 189 Cal. 248, 251-254; 207 P. 1009, 1010-1011. Mr. Donaher's letter to Mr. Trager merely confirmed a conversation of a few days earlier, stated that Debtor had been accruing a monthly charge but not paying it, and indicated that the accounting department would cancel the monthly accrual. Since the Option was canceled, there would be nothing to accrue in the future. Other than that the letter simply stated facts, i.e., accrual and nonpayment. There was no recognition of the aggregate amount that had been accrued to date, no statement of Debtor's liability, and no promise to pay or expression of a willingness to pay the accrued fees.

From the foregoing the court concludes that Debtor is liable to NDI on account of Option fees, but only for those that became due and owing within four years of Debtor's Chapter 11 petition. See California Code of Civil Procedure § 337.1. Based upon an April 1991 Launch, the monthly Option fees would have reached

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[14] Although the court has chosen to apply California law, the parties are in agreement that the elements for an effective tolling of a statute of limitations are similar under the laws of California and Virginia. Ingram v. Harris, 174 Va. 1, 5 S.E.2d 624 (1939), Clunin v. First Federal Trust Co., 189 Cal. 248, 207 P. 1009 (1922).

$20,000 per month by April 1994. NDI may only recover fees that were accrued during or after September 1994, until termination of the Option in February 1995. It follows that NDI is entitled to six months' fees at $20,000 per month, or a principal award of $120,000.

C. NDI did not waive its entitlement to Option fees nor is it guilty of latches.[15]

For the reasons stated in NDI's trial brief, Debtor's defense to the Option fees based upon waiver or latches must fail. In short, NDI did nothing in the nature of a voluntary, intentional abandonment of a known right, and may not be said to have waived such a right. Perini v. Perini, 225 Cal. App. 2d 399, 407; 37 Cal. Rptr. 354, 359 (1964); Fox v. Deese, 234 Va. 412, 425-426; 362 S.E.2d 699, 707 (1987). Nor is NDI guilty of latches. There is nothing inequitable about allowing NDI to recover the Option fees. To deny such a recovery (albeit substantially reduced in view of the statute of limitations decision adverse to NDI) merely because a party "did not focus" on its entitlement to recover what otherwise was owing to it would be unfair and inequitable.

D. NDI is entitled to its Lost Profits.

Debtor contends that NDI terminated the Agreement, thus precluding it from recovering anything other than the unpaid Service Fees and the accrued Option fees. By terminating the Agreement, rather than suspending performance, Debtor argues that

[15] At trial Debtor abandoned its theory that NDI was estopped from seeking the Option fees.

NDI forfeited its rights to the Lost Profits.

Debtor starts with Jacqueline Weiss' September 15, 1995 letter on behalf of NDI to Debtor which makes reference to the Agreement, then recites the then present delinquencies in unpaid Service Fees, and finally indicates NDI's decision to terminate the Agreement effective as of September 18, 1995. The September 15, 1995 letter also recites other facts which Debtor cannot deny: by that date Debtor had ceased transmitting data to NDI; Debtor was not communicating with NDI; NDI advised all callers that contacts with it were to be made in writing. This, of course, is completely consistent with the virtual cessation of all business activity by Debtor as of that date.

From that starting point Debtor relies on Postal Instant Press, Inc. v. Sealy, supra, 43 Cal. App. 4th 1704, 51 Cal. Rptr. 2d 365 ("PIP") for the proposition that NDI, and not Debtor, is responsible for NDI's Lost Profits and that termination of the Agreement ended all of the parties future legal relationships. The problem with this argument is that it overlooks the fact that the Agreement was not drafted in a precise enough manner to distinguish between remedies upon default versus termination rights. It is not unreasonable, therefore, for the court to infer that NDI was memorializing its termination of the delivery of data for Debtor by its words; nowhere did it evidence an intention to relieve Debtor of the consequences of its breach. As noted previously, NDI specifically kept open the possibility of serving Debtor in the future under certain circumstances, including Debtor's payment of delinquent Service Fees.

This case far more resembles Hollywood Cleaning & Pressing

Co. v. Hollywood Laundry Service, Inc., 217 Cal. 131, 17 P.2d 712 (1932) than it does PIP. The Hollywood Cleaning case, as with Gold Mining & Water Co. v. A.B. Swinerton, 23 Cal.2d 19, 142 P.2d 22 (1943), involves a complete breach, entitling the nonbreaching party to lost future profits. It strains the imagination of the court to believe that Debtor did not cause the consequences of its own failure to live up to its obligations under the Agreement, particularly under circumstances where it was essentially out of business.[16] While PIP does interpret California contract law, it quite obviously is premised upon the unequal bargaining position of franchisors and franchisees and the obvious fact that a franchisor's decision to terminate a franchisee's ability to generate revenues necessarily leads to the loss of royalties that are based upon the very source of revenues that is terminated. In fact, the franchisor in PIP terminated the franchise and sued to recover lost future royalties with approximately seven years remaining on the franchise agreement. Here NDI had nothing to do with Debtor's termination of business, it left open the possibility of serving Debtor again if and when the unpaid Service

[16] This court notes the overly sanguine approach of the court in PIP, suggesting that plaintiff should have kept the contract in effect and sued the breaching party "again or perhaps again and again" to compel the franchisee to pay those future royalties in a timely fashion. 43 Cal. App. 4th at 1711, 51 Cal. Rptr. at 370. The court then suggests that such a tactic would be a strong lesson to the defendants, who would have learned that having to pay the plaintiff's attorneys' fees as well as interest and costs would render it highly unlikely that they would have ever again been late in making their royalty payments after losing the first collection action brought against them. The realities of business failures are well-known to bankruptcy lawyers and bankruptcy judges, and thus the state court's suggestion of how the defendants in PIP might have behaved in the future seems to lack a firm basis in reality.

Fees were paid and it refrained from filing suit. By the time of Debtor's Chapter 11 filing there were only a few months remaining on the term of the Agreement. In truth there is very little "future" left about the profits NDI claims. It merely seeks to recover the benefit of its bargain under California Civil Code section 3300.[17]

As in Hollywood Cleaning, NDI is entitled to recover its Lost Profits, forcing the court to focus on the adequacy of the expert testimony presented by NDI and the effectiveness of Debtor's expert's response.

E. Calculation of Lost Profits.

Preliminarily the court notes that while California Civil Code section 3301 indicates that no damages can be recovered for a breach of contract which are not clearly ascertainable in both their nature and origin, the injured party may recover for the profits or benefits which [it] would have obtained by performance if [it] can establish them with reasonable certainty. See 1 B. Witkin, Summary of California Law, § 823 at 741 (9th ed. & Supp. 1999) and cases cited therein, including G.H.K. Associates v. Mayer Group, 224 Cal. App. 3d 856, 873-875; 274 Cal. Rptr. 168, 179-180 (1990) ("where the fact of damages is certain, the amount of damages need not be calculated with absolute certainty.... the

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[17] California Civil Code section 3300 provides:

> For the breach of an obligation arising from contract, the measure of damages, except where otherwise expressly provided by this Code, is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom.

law requires only that some reasonable basis of computation of damages be used, and the damages may be computed even if the result reached is an approximation....").

NDI's expert, John R. Skelton, submitted a report wherein he concluded that based upon NDI's situation at the time of Debtor's breach, it would incur no additional expenditures (other than de minimus expenditures) had it been able to continue to provide VBI data delivery services to Debtor. He reasoned that a continuation of those services would not have increased NDI's costs. He also did not consider data delivery fees that NDI would be required to pay under applicable profit sharing agreements, deciding that profit sharing is not a proper incremental expense item.

Mr. Skelton's credentials were not challenged, but only the alleged inadequacy of his report. Debtor's expert, Mr. Joseph T. Anastasi, engaged only in speculation as to what Mr. Skelton might have done; he offers no specific evidence as to what Mr. Skelton should have done. Specifically, he indicates that he has not seen evidence to prove that Mr. Skelton examined NDI's activities or business records to validate information Mr. Skelton received from NDI's management. He also expressed his own doubts about cross-categories that might have variable components that were related to service delivery.[18] As to non-salary expense categories that changed after 1995, again Mr. Anastasi speculated that they might have variable components, but nowhere does he prove that they did have variable components. He then goes on to indicate that Mr. Skelton did not provide a full explanation for various increases

[18] Mr. Skelton in fact explained those variables.

in certain costs, but Mr. Anastasi does not provide facts that such increases occurred, other than facts that can be explained away as they were by Mr. Skelton.

Finally, Mr. Anastasi jumps to a conclusion that data delivery fees are true costs of doing business without rebutting Mr. Skelton's expert opinion that they are in the nature of profit sharing and need not be considered.

Mr. Anastasi also goes on to suggest that Mr. Skelton's analysis is flawed because it does not take into account a history of renegotiation of terms of the Agreement and the possibility that the parties might have terminated the contract without cause. While both of those events might have occurred, there is no evidence that they ever did occur. More importantly, Debtor has not provided convincing authority to suggest to the court that it should engage in such subjective speculation when applying the benefit of the bargain test on a breach of contract.

On balance, the court concludes that Debtor did not adequately challenge Mr. Skelton's expert testimony, nor did it establish with any degree of certainty that what Mr. Skelton called de minimus was in fact a measurable expense item that should be subtracted from the gross revenues that NDI would have received had Debtor paid the Service Fees. Thus, the court will characterize Mr. Skelton's analysis as "gross equals net," a conclusion that Debtor has not rebutted. NDI's Lost Profits amount to its unpaid Service Fees.

From the foregoing, the court decides that NDI is entitled to its Lost Profits, namely the sum of $83,333.33 per month from October, 1995 to August, 1999, for a total of $3,916,667.

F. NDI is entitled to interest on the unpaid Option fees but not on the Lost Profits.

Because the Option fees were readily calculable, and in fact had been accrued on Debtor's books, there is no reason why the court should not conclude that the unpaid Option fees are "damages certain or capable of being made certain by calculation" as provided for in California Civil Code section 3287(a). There is nothing to suggest that Debtor could not reasonably ascertain what amount was owed. Accordingly, NDI is entitled to prejudgment (pre-petition) interest at the rate of 10% per annum in accordance with California law on account of the $120,000 of unpaid Option fees awarded herein. That interest should be calculated on a monthly basis for each of the six months for which the fees were accrued and are thus allowed in this case.[19] In addition, NDI will be entitled to post-petition interest under the terms of Debtor's Chapter 11 plan of reorganization.

As far as the Lost Profits are concerned, those amounts were not capable of being made certain by calculation at any time prior to trial, even thought at first blush it appears to be a simple matter of multiplying $83,333.33 x 47. In fact, NDI first asserted Service Fees based upon a 50% profit margin. It was only later, after it consulted Mr. Skelton, that it changed the theory of its case as set forth in the Claim to its 100% profit margin. And even after that, Mr. Skelton's expert analysis was necessary and might have even been offset in part by contrary expert

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[19] If Virginia law applied, the interest rate would be 9% and may be awarded in the discretion of the court. For the reasons stated in the text, such an award would be proper under Virginia law.

testimony had the Debtor presented any specific facts in rebuttal. Thus, the ready analysis is not something that could have been determined until this matter went to trial, and under no circumstances absent that analysis could Debtor have known of the amount that was owed. Accordingly, NDI is not entitled to prejudgment (pre-petition) interest on account of the Lost Profits.

III. Conclusion

Within thirty days counsel for NDI should submit a form of order allowing the Claim in an amount consistent with this Memorandum Decision. Unless counsel for Debtor agrees to the calculation of interest on the Option fees, counsel for NDI should submit a declaration setting forth how that interest has been calculated when the proposed form of order is submitted. Counsel for Debtor will have seven days to challenge the calculation.

Counsel for NDI shall comply with B.L.R. 9021-1 and 9022-1.

Dated: July __, 2000

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Dennis Montali
United States Bankruptcy Judge